

# GLOBAL ECONOMIC OUTLOOK – AUGUST

Monetary and Statistics Department  
External Economic Relations Division

2013

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The August issue of Global Economic Outlook presents its regular overview of recent and expected developments in selected advanced and emerging economies, focusing on key economic variables such as GDP, inflation, leading indicators, interest rates, exchange rates and commodity prices. In this issue, *Focus* examines in more detail on the different evolution of GDP and GNP, which is due to capital flow liberalisation in small economies and may pose economic and political problems for these economies in the future.

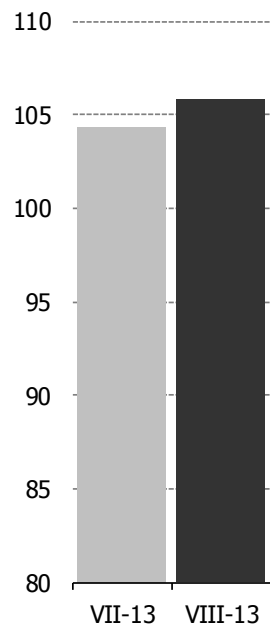
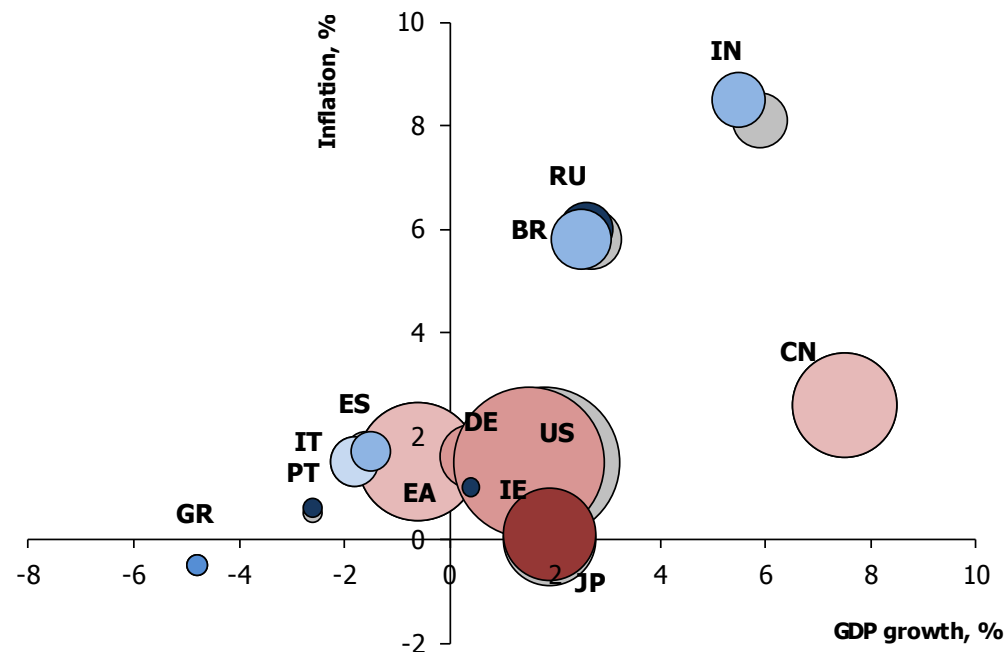
The outlook for economic growth this year has stabilised in most of the countries monitored; only the outlooks for the USA, India and Brazil deteriorated in August. Most advanced countries saw a further improvement of leading indicators, supporting expectations that GDP growth in advanced economies should accelerate in 2014. In the BRIC countries, by contrast, the growth outlook for next year deteriorated. The inflation outlook remains stable for most countries, as the slow and uncertain global economic recovery and commodity market developments currently signal no inflationary risks.

Fed representatives have been trying to clarify their intentions regarding the tapering of the monetary stimulus (which could occur before the end of this year). These efforts have calmed volatile exchange rates. Although the US economic recovery is still surrounded by uncertainty, the dollar should appreciate against major world currencies at the one-year horizon. Short-term USD LIBOR interest rates were flat in July and even resumed a falling trend at the one-year maturity. However, their outlook is rising significantly more than the outlook for euro area rates, which were flat at both the three-month and one-year maturities owing to the ECB's commitment regarding the future path of its policy rate.

World prices of oil increased in July, with Brent crude oil being supported mainly by tensions in the Middle East and OPEC production shortfalls. The price of WTI crude oil rose more markedly as a result of a drop in stocks and higher refinery activity in the US inland. This led to a narrowing of the spread between both benchmarks to almost a three-year low. Renewed interest of financial investors can also be observed on the oil market. The oil market price outlook remains falling due to satisfactory oil supply. Within non-energy commodities, prices of agricultural products saw the largest decline in July, while prices of industrial metals switched to moderate growth.

#### Outlook for the global economy in 2013

#### Outlook for Brent crude oil prices in December 2013



GNP / GDP, %

82 -97 < 98 < 99 < 100 < 101 < 102 < 103

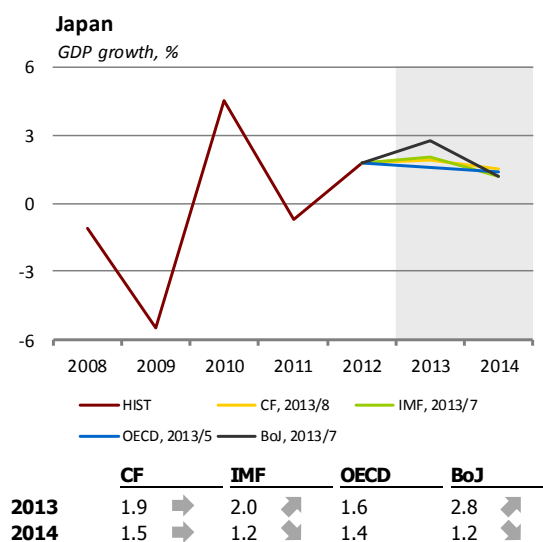
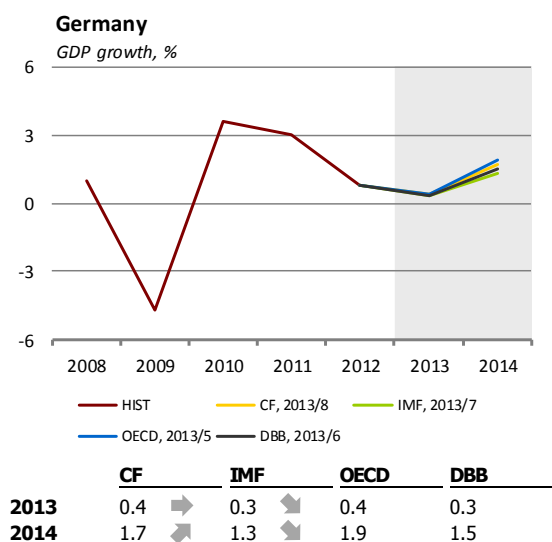
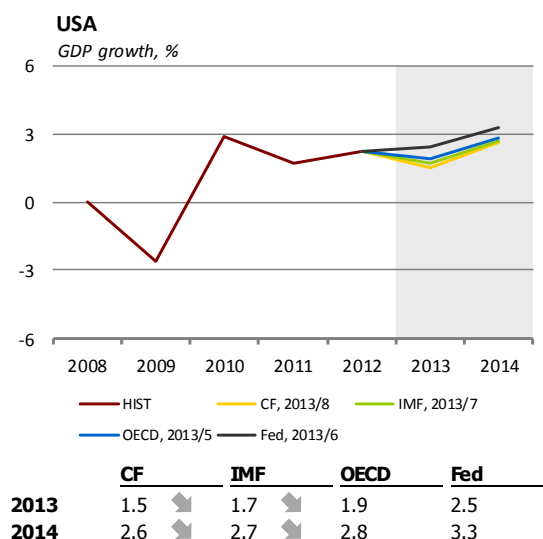
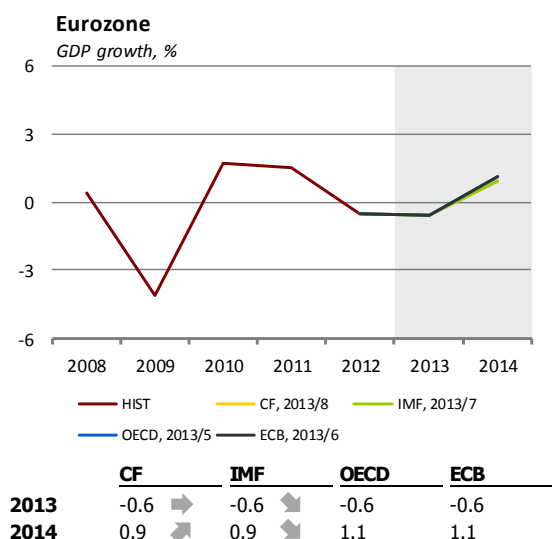
The size of each point represents the size of the country/region according to nominal GDP in US dollars in 2011. The colour of the points is assigned according to the GNP/GDP ratio in 2010. The grey colour is the CF forecast (GDP, inflation) or Bloomberg survey (oil price) for the previous month.

[Uzávěrka dat: 15. August 2013]

Zdroj: Bloomberg, Consensus Economics, World Bank, CNB calculations.

II.1 GDP outlook in advanced countries

New data point to a slight recovery in euro area growth in the second half of this year, owing chiefly to an expected improvement in Germany. Nevertheless, the August CF left the outlooks for the euro area and Germany this year unchanged at -0.6% and 0.4% respectively. By contrast, CF significantly revised this year's outlook for the USA, lowering it by 0.3 pp to 1.5%. This outlook was probably influenced by both a revision of the data for 2012 and a decrease in quarterly growth. From the macroeconomic perspective, US economic growth is being dampened by tax increases, slowing domestic consumption growth and subdued global economic activity. Next year, US GDP growth is expected to be 0.1 pp lower (i.e. 2.6%). The outlook for Japan is unchanged: growth of 1.9% in 2013 and a slowdown to 1.5% in 2014.



Note: Legend shows latest forecast data in format "Source, year/month" of forecast publication. HIST: historical values. ECB and Fed: midpoint of range. Arrow indicates direction of revision of newly published forecast. If no arrow is shown, no new forecast was available in previous month or by cut-off date in current month. Asterisk indicates first published forecast for given year.

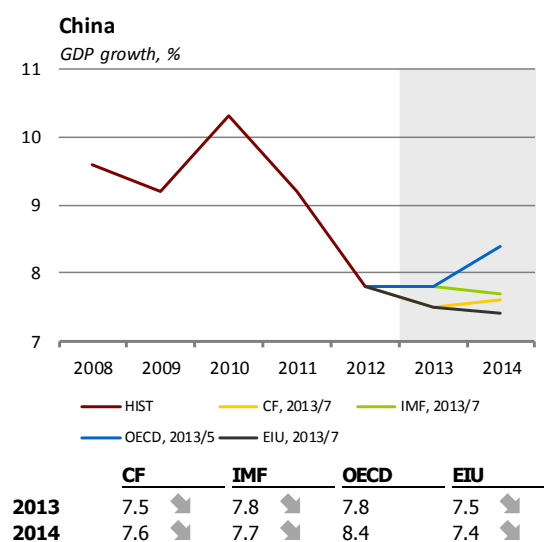
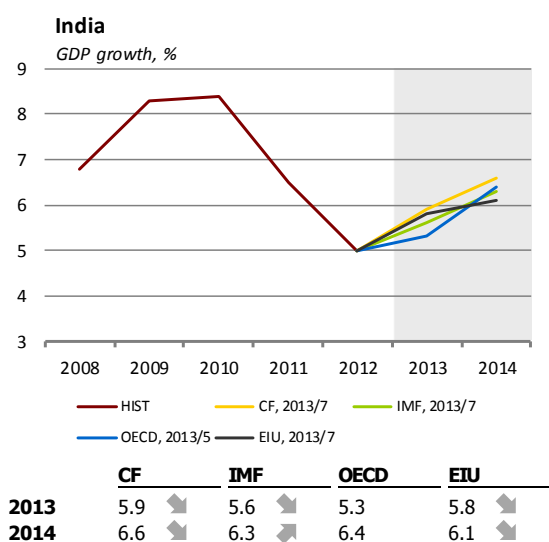
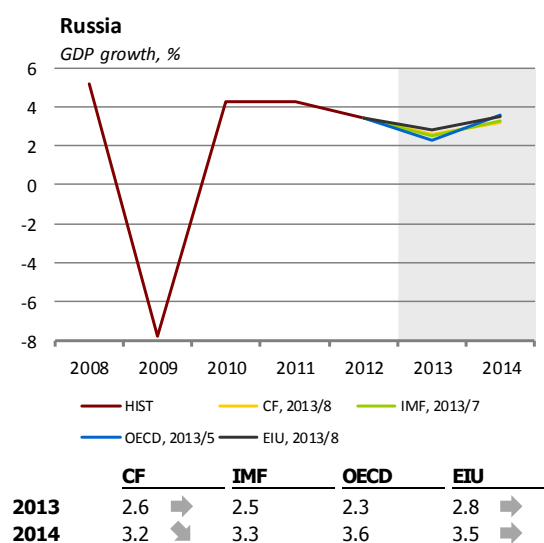
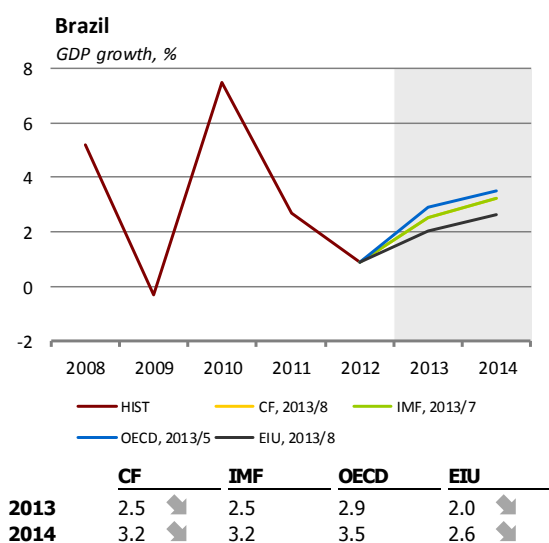
[Cut-off date for data: 16 August 2013]

Source: CF, IMF, OECD, ECB, Fed, DBB, BoJ, CNB calculations.

## II.2 GDP outlook in BRIC countries

As in previous months, the GDP growth outlooks for the BRIC countries decreased. According to the August CF, the growth outlook for India worsened the most. CF predicts that India will grow by 5.5% in 2013, i.e. 0.4 pp less than expected by the July CF. The deteriorating forecast may be due to data on industrial production, which fell by 2.2% in July, continuing its downward trend. Brazil's GDP outlook worsened as well. CF reduced its forecast by 0.2 pp and EIU reduced its by 0.5 pp. The uncertain growth is also in line with leading indicators (the PMI and the consumer confidence indicator). China should maintain growth of 7.5% this year, which is also the target of the Chinese government. No doubt this will also be aided by the increase in trade indicated by the July data. Russia is expected to grow by 2.6% this year. However, its growth will depend on commodity price developments.

The CF outlook for 2014 deteriorated for all the monitored countries. The predictions for Russia and China fell by just 0.1 pp, while those for Brazil and India decreased by 0.2 pp and 0.3 pp respectively.



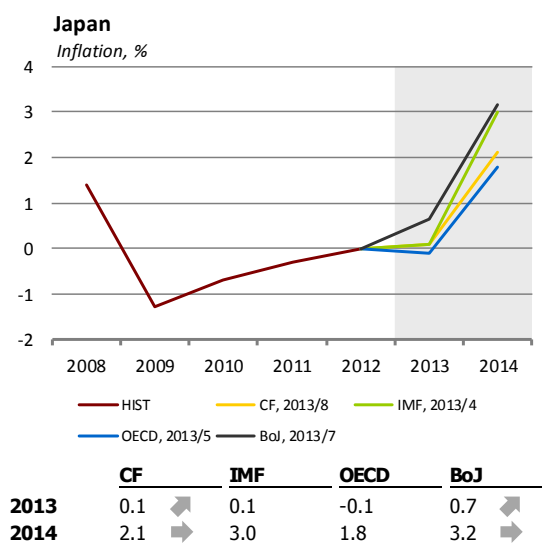
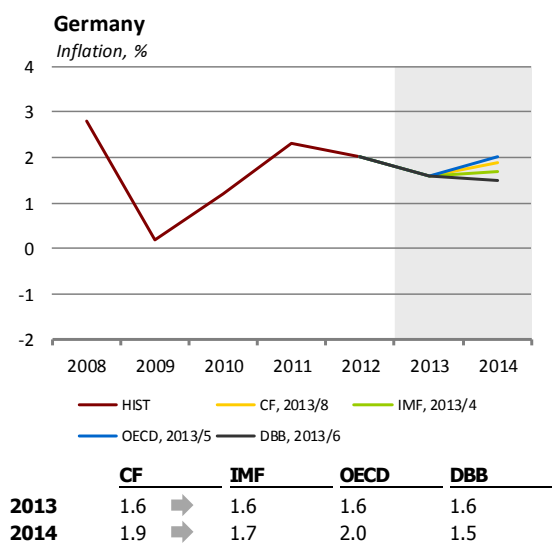
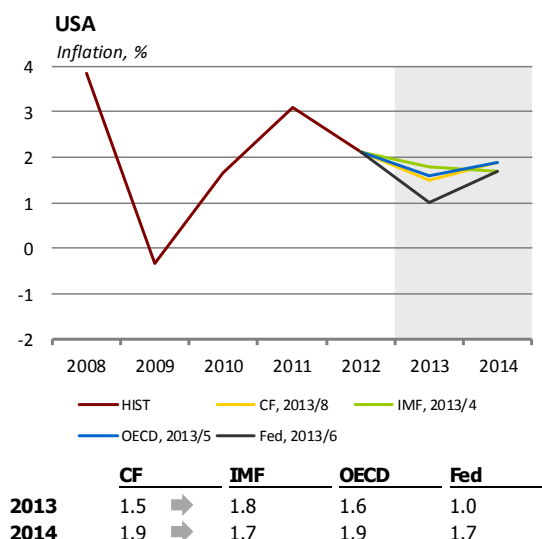
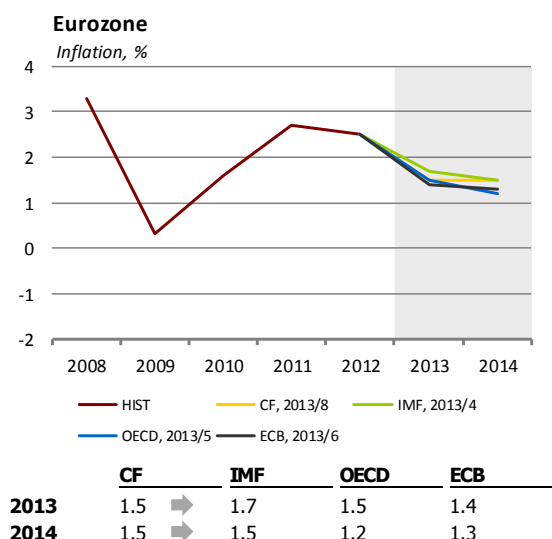
Note: Legend shows latest forecast data in format "Source, year/month" of forecast publication. HIST: historical values. Arrow indicates direction of revision of newly published forecast. If no arrow is shown, no new forecast was available in previous month or by cut-off date in current month. Asterisk indicates first published forecast for given year.

[Cut-off date for data: 15 August 2013]

Source: CF, IMF, OECD, EIU, CNB calculations.

### II.3 Inflation outlook in advanced countries

The new CF did not change the inflation outlooks for the monitored European economies and the USA for 2013 and 2014, as the slow and uncertain economic recovery and global commodity market developments currently signal no inflation pressures. The outlook has thus remained at 1.5%–1.6% for 2013 and 1.5%–1.9% for 2014 since May. Annual inflation in Japan turned positive in June for the first time in more than a year. This was due to a weakening of the yen, which was reflected in the costs of imported energy and, in turn, headline inflation. CF increased its inflation outlook for Japan this year by 0.1 pp to 0.1%. Consumer price inflation should rise to 2.1% next year.

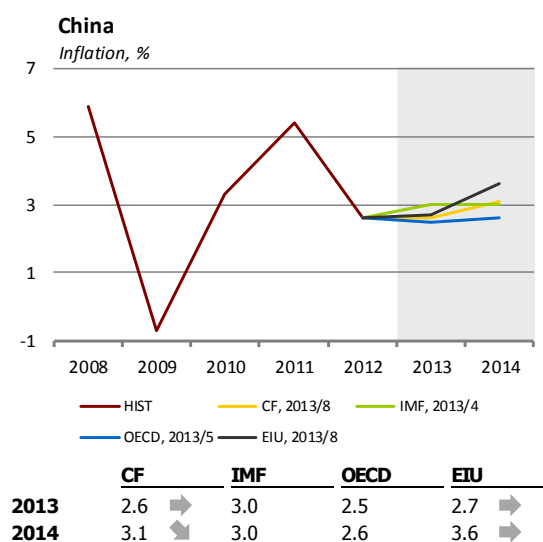
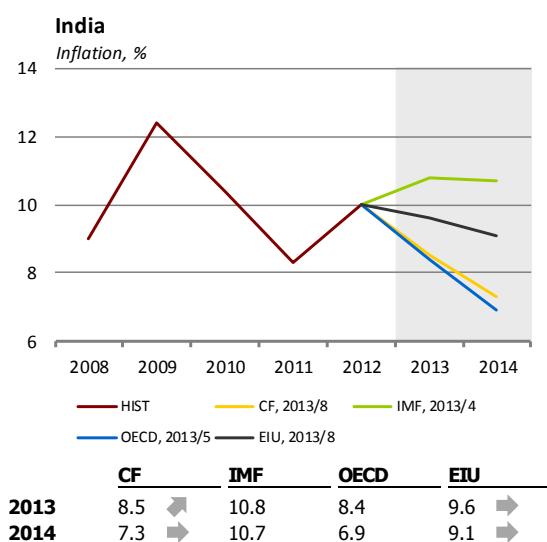
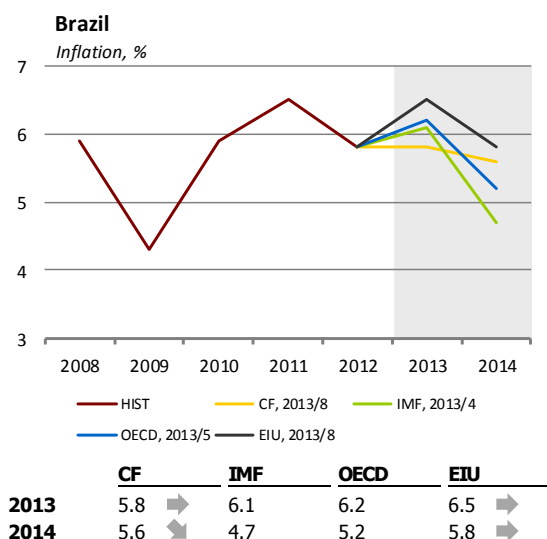


Note: Legend shows latest forecast data in format "Source, year/month" of forecast publication. HIST: historical values. ECB and Fed: midpoint of range. Arrow indicates direction of revision of newly published forecast. If no arrow is shown, no new forecast was available in previous month or by cut-off date in current month. Asterisk indicates first published forecast for given year.  
[Cut-off date for data: 16 August 2013]  
Source: CF, IMF, OECD, ECB, Fed, DBB, BoJ, CNB calculations.

## II.4 Inflation outlook in BRIC countries

No major changes have occurred in the inflation forecast for the BRIC countries since the last issue of GEO. The only exception is the CF outlook for inflation in India. Although annual consumer price inflation in India moderated to 9.6% in July, owing mainly to food prices, CF shifted its inflation prediction upwards by 0.4 pp to 8.5%. Consumer price inflation in Russia has been slowing gradually over the last two months, reaching 6.5% in July. However, CF increased its inflation estimate for this country by 0.1 pp. In China, producer prices declined for the seventeenth consecutive month, reflecting China's weakening economic growth. Also for this reason, inflation in China should stay below the government's target of 3.5% according to CF. In Brazil, annual inflation dropped into the central bank's tolerance band, thanks mainly to food prices.

The estimates for 2014 were unchanged or only very slightly lower.

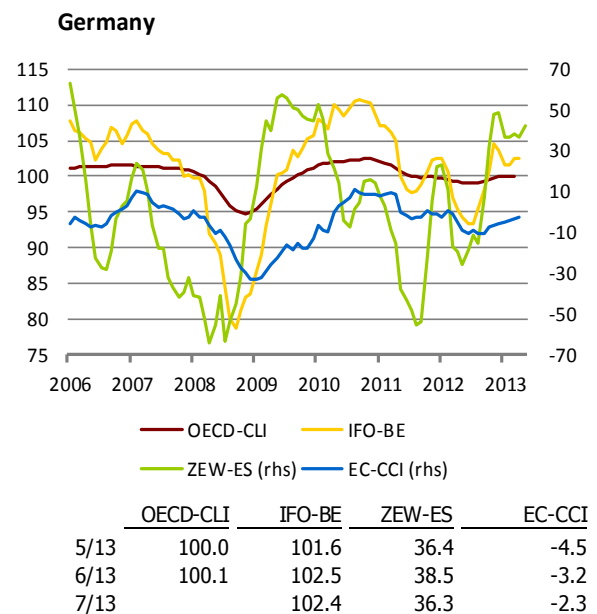
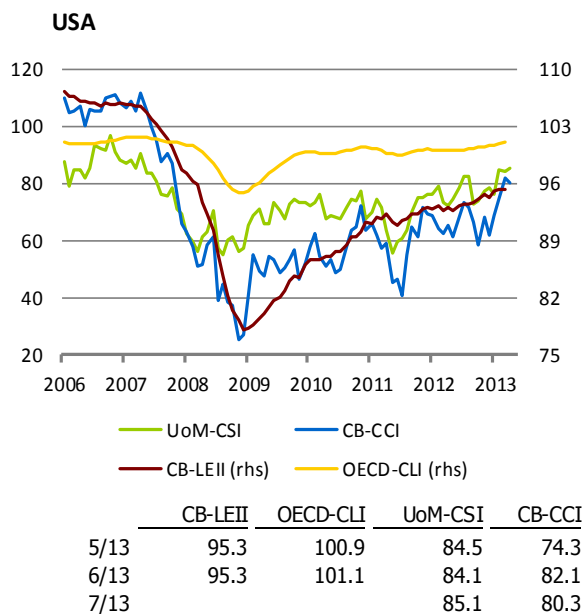
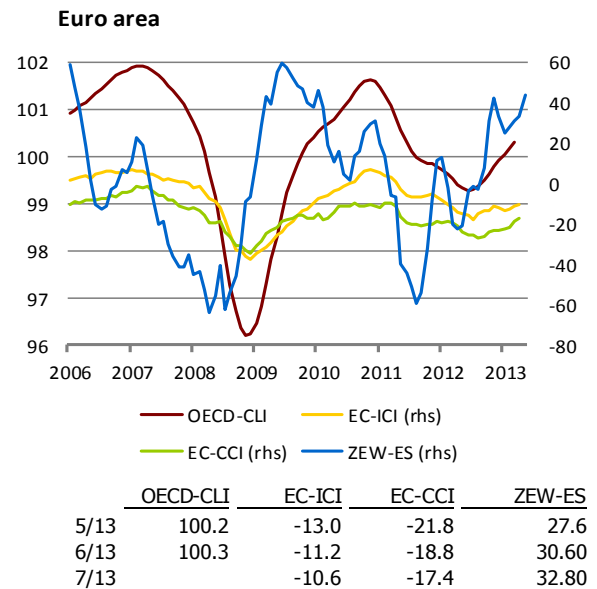
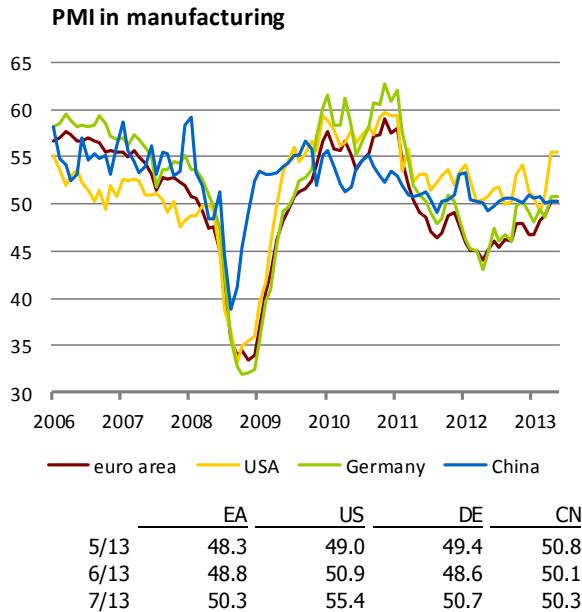


Note: Legend shows latest forecast data in format "Source, year/month" of forecast publication. HIST: historical values. Arrow indicates direction of revision of newly published forecast. If no arrow is shown, no new forecast was available in previous month or by cut-off date in current month. Asterisk indicates first published forecast for given year.

[Cut-off date for data: 15 August 2013]

Source: CF, IMF, OECD, EIU, CNB calculations.

Overall, the leading indicators are pointing to an improvement for all the monitored regions. The US PMI recorded a significant increase in July. It was supported by all components, ranging from new orders, the production index and employment to a decline in the price index due to a fall in raw material prices. For the first time in two years, the euro area PMI also exceeded the threshold of 50 points separating growth from contraction. The PMI also remains slightly above this level in Germany and China. Other leading indicators for the euro area are improving as well, suggesting an expected recovery. In the USA, only the expectations component of the CB-CCI index deteriorated. By contrast, the component evaluating the current situation strengthened. The leading indicators for Germany are also improving. The Ifo index of business expectations is the only exception, having recorded a very slight decrease.



Note: **PMI** = Purchasing Manager Index (50); **OECD-CLI** = OECD Composite Leading Indicator (100); **EC-ICI** = European Commission Industrial Confidence Indicator (0); **EC-CCI** = European Commission Consumer Confidence Indicator (0); **ZEW-ES** = ZEW Economic Sentiment (0); **CB-LEII** = Conference Board Leading Economic Indicator Index (2004 = 100); **UoM-CSI** = University of Michigan Consumer Sentiment Index (Dec 1966 = 100); **CB-CCI** = Conference Board Consumer Confidence Index (1985 = 100); **IFO-BE** = IFO Business Expectations (2005 = 100). Values in parentheses indicate the index threshold between expected economic expansion and decline or the period as of which the index was normalised. [Cut-off date for data: 15 August 2013]

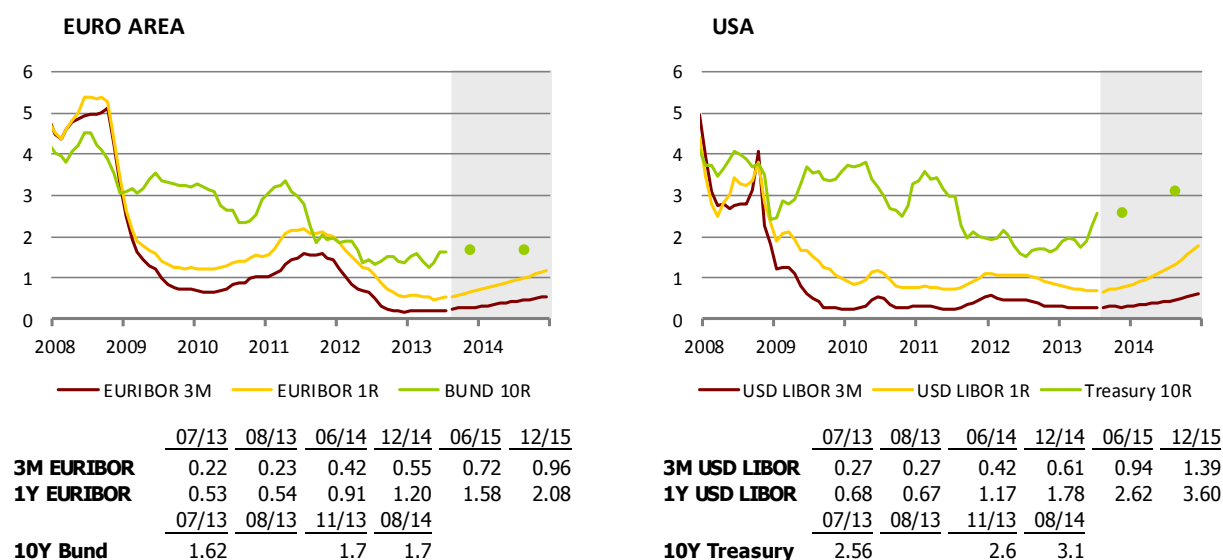
Source: OECD, EC, IFO, Conference Board, University of Michigan, CNB calculations.



### IV.1 Interest rate outlook in the euro area and the USA

In July and the first ten days of August 2013, both the 3M and 1Y EURIBOR rates were flat, at 0.22% and 0.52% respectively. Interest rate stability was supported by the ECB's commitment regarding the future path of its policy rate, and the August meeting of the Governing Council confirmed the current orientation of monetary policy. The decline in excess liquidity slowed in the same period. Movements in market rates cannot be expected at the current excess liquidity level (EUR 256 billion). The new market rate outlook expects the 3M EURIBOR to be stable at least until the end of 2013, and the August CF also revised the outlook for the ten-year German government bond yield to 1.7% at both the three-month and one-year horizons.

The 3M USD LIBOR was also flat in the period under review, while the 1Y rate resumed its decline, reaching 0.66% in early August. However, the market outlooks saw no major changes. The 1Y LIBOR will exceed 2% before the end of 2014, whereas the 3M rate will remain below 1%. On the other hand, the August CF again increased the outlook for the ten-year government bond yield over the entire horizon.



Note: Forecasts for EURIBOR and LIBOR rates are based on implied rates from interbank market yield curve (FRA rates are used from 4M to 15M and adjusted IRS rates for longer horizons). Forecasts for German and US government bond yields (10Y Bund and 10Y Treasury) are taken from CF. [Cut-off date for data: 12 August 2013]

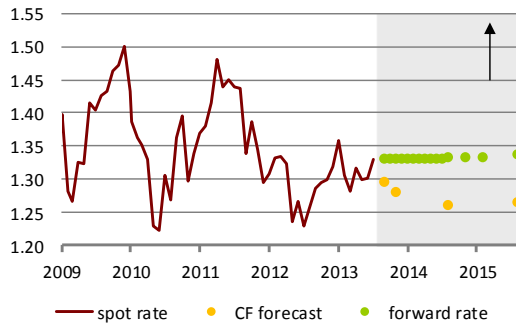
Source: Thomson Reuters (Datastream), Bloomberg, Consensus Forecasts, CNB calculations.

### IV.2 Outlook for selected exchange rates

The Fed's efforts to clarify its next steps leading to a tapering of the monetary stimulus led to a moderation of exchange rate movements, and not only in the case of the advanced economies' currencies. The quantitative easing programme should be scaled back before the end of 2013, but uncertainty remains regarding the US economic recovery. However, the new forecasts saw no major changes. The August CF continues to expect all the selected advanced economies' currencies to depreciate against the US dollar at the one-year horizon. The still fragile recovery and political uncertainty are acting against the single European currency, while the Japanese yen remains under pressure due to radical economic policies and concerns regarding target fulfilment. An important factor for the pound is the Bank of England's new commitment to keep its main policy rate at the current level until unemployment falls below 7%. A weak recovery of the Swiss economy, deflation and an easing of euro area financial market tensions have kept the exchange rate of the Swiss franc against the euro below the official upper limit for many months; according to CF, this trend should continue in the next two years. Further depreciation pressure may be generated by new steps taken by the central bank (e.g. negative rates) aimed at countering deflation.

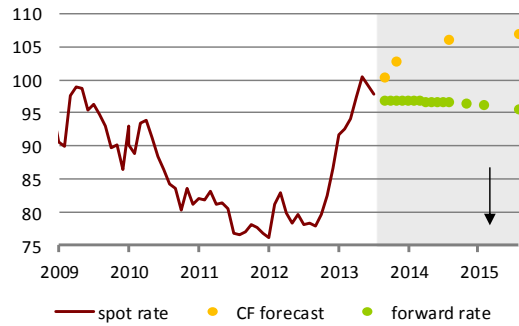
The depreciation trend of the currencies of the BRIC countries (except China) continued in the period under review amid fluctuations reflecting changing sentiment vis-à-vis the US dollar. This depreciation is in turn supporting inflation in some countries, to which central banks are responding by changing interest rates or intervening (Brazil). The weakening of the Indian currency has been particularly pronounced, prompting the central bank to impose a number of additional capital restrictions. The growth prospects of the BRIC countries also worsened, but the new CF forecast expects exchange rate stability at the one-year horizon. The Chinese renminbi started to appreciate again in late July as the central bank managed to stabilise liquidity in the banking system and then also to curb lending growth. Currency appreciation is also being supported by speculation that China will further open its capital markets to foreign investors.

US\$ per Euro



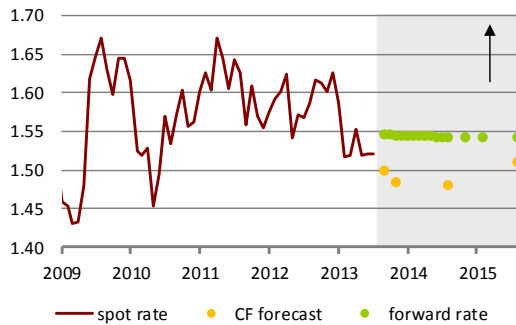
	12/08/13	09/13	11/13	08/14	08/15
spot rate	1.330				
CF forecast		1.296	1.280	1.261	1.265
forward rate		1.330	1.330	1.332	1.337

Yen per US\$



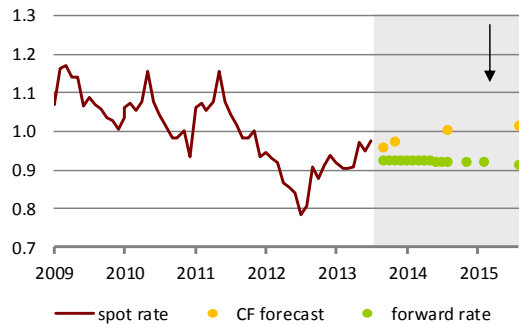
	12/08/13	09/13	11/13	08/14	08/15
spot rate	96.90				
CF forecast		100.40	102.70	106.00	106.80
forward rate		96.88	96.85	96.56	95.65

US\$ per UK£



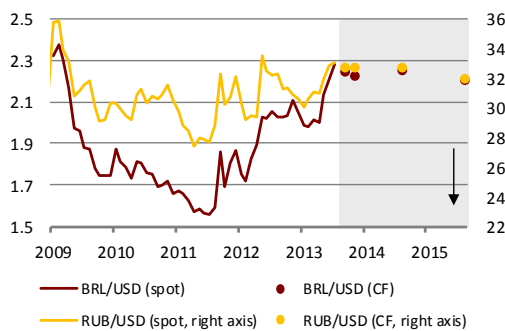
	12/08/13	09/13	11/13	08/14	08/15
spot rate	1.546				
CF forecast		1.500	1.484	1.481	1.510
forward rate		1.546	1.545	1.543	1.542

Swfr per US\$



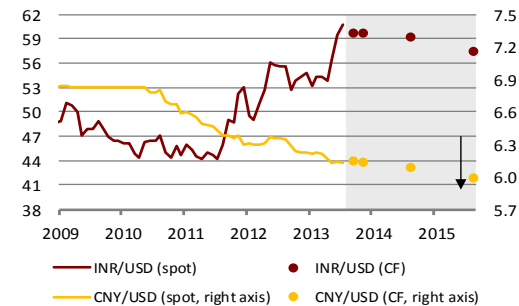
	12/08/13	09/13	11/13	08/14	08/15
spot rate	0.926				
CF forecast		0.957	0.975	1.004	1.016
forward rate		0.926	0.925	0.922	0.915

BRAZILIAN REAL, RUSSIAN ROUBLE



	12/08/13	09/13	11/13	08/14	08/15
BRL/USD (spot)	2.27				
BRL/USD (CF)		2.25	2.23	2.25	2.20
RUB/USD (spot)	32.99				
RUB/USD (CF)		32.74	32.68	32.67	31.99

INDIAN RUPEE, CHINESE RENMINBI



	12/08/13	09/13	11/13	08/14	08/15
INR/USD (spot)	61.15				
INR/USD (CF)		59.80	59.72	59.32	57.54
CNY/USD (spot)	6.12				
CNY/USD (CF)		6.15	6.13	6.09	5.99

Note: Arrow indicates currency appreciation against US dollar. Exchange rates as of last day of month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibility of hedging future exchange rate. [Cut-off date for data: 12 August 2013]

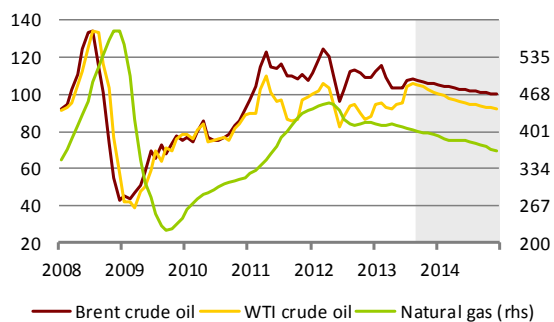
Source: Thomson Reuters (Datastream), Bloomberg, Consensus Forecasts, CNB calculations.

## V.I Oil and natural gas

The average prices of Brent crude oil and WTI crude oil went up in July. Brent reached a four-month high of USD 107.4, up by USD 4 on June. WTI rose more sharply, by USD 8.8 a barrel to USD 104.5 a barrel, the highest level in sixteen months. The spread between the two benchmarks therefore narrowed to almost the lowest level in three years. The price of Brent crude oil rose owing mainly to tensions in the Middle East and production shortfalls in some OPEC countries – Iraq, Iran and Nigeria – which were not offset by increased production in Saudi Arabia. Moreover, oil consumption in Europe unexpectedly rose for the first time in two years in April and May, and a similar trend is probably continuing. US oil prices rose because of falling stocks at Cushing, due chiefly to growing demand from refineries. Higher WTI oil prices also reflect good news from the US economy. The higher prices of both benchmarks are also reflected in investor activity, as the number of open net long positions of managed money funds is the highest since September 2009. Despite many speculative positions, the futures-based oil price outlook is still falling. Prices should be above USD 103 a barrel in late 2013 and fall to just below USD 100 a barrel in late 2014. The August CF expects USD 105.4 at the end of November 2013 and USD 105.3 at the end of August 2014.

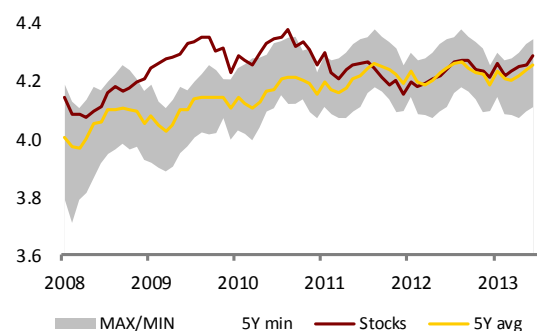
The EIA lowered its oil consumption forecast for 2014 by 0.1 million barrels a day in light of a revised IMF global economic growth prediction. Expected demand growth in 2013 remains at 0.9 million barrels a day, rising to 1.1 million barrels a day in 2014. The EIA also increased its world oil supply forecast for 2013 to 91.85 million barrels a day (due to higher supplies from non-OPEC countries, mainly in North America, which should outweigh lower supplies from OPEC countries, mainly Libya and Iraq). Commercial stocks in OECD countries grew for the fourth consecutive month, still fluctuating close to the five-year average.

**OUTLOOK FOR PRICES OF OIL AND NATURAL GAS**

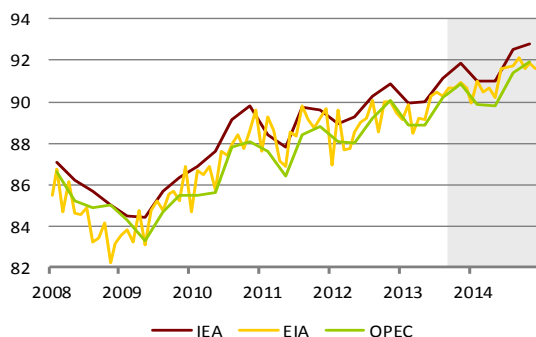


	Brent	WTI	Natural gas
2013	-3.71 ↘	5.29 ↘	-5.80 ↘
2014	-4.71 ↘	-3.55 ↘	-6.38 ↘

**TOTAL STOCKS OF OIL AND OIL PRODUCTS IN OECD**

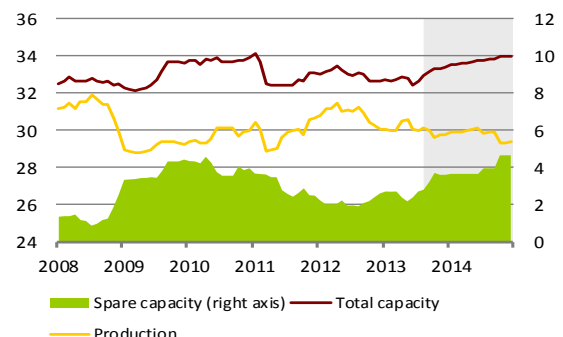


**GLOBAL CONSUMPTION OF OIL AND OIL PRODUCTS**



	IEA	EIA	OPEC
2013	1.00 ↘	1.22 ↘	0.98 ↘
2014	1.21 ↘	1.35 ↘	1.14 ↘

**PRODUCTION, TOTAL AND SPARE CAPACITY IN OPEC COUNTRIES**



	Production	Total capacity	Spare capacity
2013	-2.79 ↘	-0.31 ↘	35.55 ↘
2014	-0.80 ↘	2.57 ↘	37.78 ↘

Note: Oil price in USD/barrel, price of Russian natural gas at German border in USD/1,000 m<sup>3</sup> (IMF data, smoothed by the HP filter). Future oil prices (grey area) are derived from futures and future gas prices are derived from oil prices using model. Tables show annual percentage changes. Total oil stocks (commercial and strategic) in OECD countries including average, maximum and minimum in past five years in billions of barrels. Global consumption of oil and oil products in millions of barrels a day. Production and extraction capacity of OPEC in million barrels a day (EIA estimate). [Cut-off date for data: 15 August 2013]

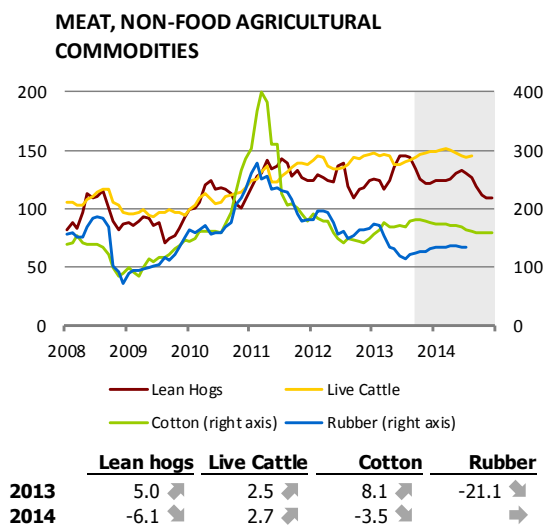
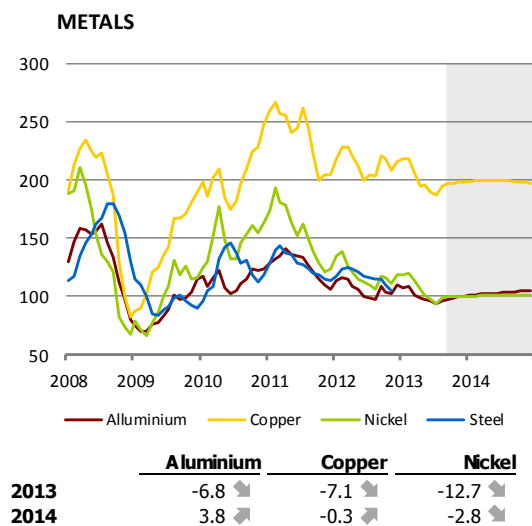
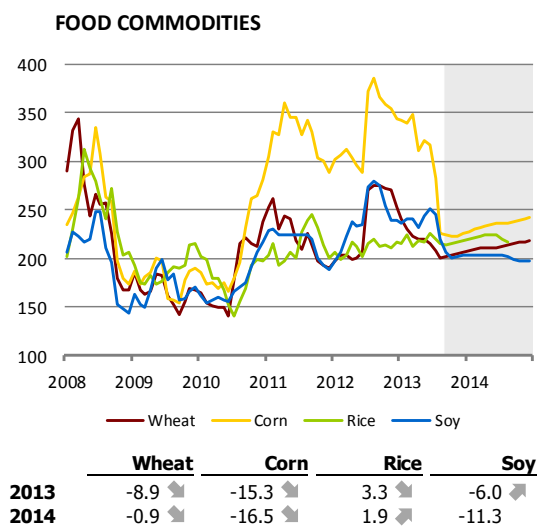
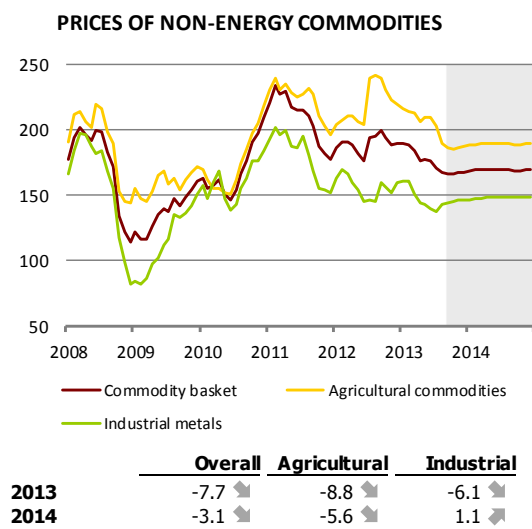
Source: Bloomberg, IEA, EIA, OPEC, CNB calculations

### V.2 Other commodities

The overall non-energy commodity price index fell by more than 2% in July, mainly because of a negative contribution of food prices. In early August the food price index declined further, but the industrial metals index switched to modest growth, which should continue in the near future.

Unlike in the previous month, developments across the components of the food commodity price index were similar in July, and prices therefore fell for almost all its components. The largest decreases were recorded for maize, wheat and soybeans on the back of positive harvest expectations. The outlook for the individual components in the short term is mostly falling, with the exception of maize and wheat, for which slight growth is expected. Pork prices were still close to their historical highs in July but declined in early August, and a marked decrease is also expected in the months ahead. By contrast, the price of beef edged up, and further increases are expected.

Prices of aluminium, copper and steel fell further in July on mixed news from the Chinese economy and uncertainty regarding the tapering of the quantitative easing programme in the USA. Conversely, the outlook for the metals price index, especially copper prices, is slightly rising. Rubber prices rebounded from four-year lows in June and are expected to rise further. Cotton prices were flat, and only a slight rise is expected.



Note: Structure of non-energy commodity price indices corresponds to composition of The Economist commodity indices. All prices are given as indices, 2005 = 100 (charts) and percentage changes (tables). [Cut-off date for data: 14 August 2013]  
 Source: Bloomberg, CNB calculations.

## The effect of globalisation on deviations between GDP and GNP in selected countries over the last two decades <sup>1</sup>

*This article discusses the mismatch between GDP formation and GDP use in a context of deepening international division of labour and liberalisation of capital flows. This topic is not frequently discussed in the economic literature because it is of generally marginal relevance to large world economies and advanced countries. For some smaller countries, however, an increase in the deviations between GDP and GNP may pose a serious economic and possibly also political problem that is not easy to resolve.*

### 1. Introduction

The sharp acceleration in the process of globalisation of the world economy since the start of the 1990s, associated with deepening international trade in goods and services (massive transfers of production of goods and services from advanced to emerging economies), and the liberalisation of capital flows (largely linked with the above) has given rise to numerous major changes in the world economy. However, besides positive effects such as lower inflation in advanced countries, higher living standards in many emerging economies and higher capital yields, there are some risks associated with this phenomenon. These include the possible existence of long-term differences between GDP formation and GDP use. This may lead to sizeable distortions in the economies, labour markets and public budgets of the countries affected.

The Czech Republic has seen a significant increase in GDP over the past 15 years, due mainly to strong inflows of foreign investment.<sup>2</sup> At the same time, however, a fairly significant deviation has started to emerge between GDP formation and the domestic use of GDP. The global economic and financial crisis has led to sizeable outflows of capital in recent years, and not only in the form of dividends. This article explores whether this phenomenon is out of the ordinary or is also common in other economies (see Fig. VI-1) and whether there are any risks associated with it.

From the theoretical standpoint, gross domestic product (GDP) is defined as the sum of consumption (C), gross private investment (I), government consumption (G) and net exports (NX) in a particular territory in a particular period. Net exports are a balancing item between GDP formed and GDP used. Theoretically, individual countries should aim to bring their net exports down to zero in the long run. Short-term (or medium-term) deviations occur in the form of positive or negative net exports. This is offset by the balance of foreign income (i.e. financial flows associated with cross-border movements of labour and the balance of income from capital allocated abroad in the past and foreign capital allocated in the home country, which together express the gross national product – GNP<sup>3</sup>), direct transfers to or from other countries, or movements of capital.<sup>4</sup> A sustained and pronounced deviation of net exports from equilibrium typically leads to a gradual widening of the income imbalance. Statistically, all these operations ensuring balance between GDP formed and GDP used are reflected in the balance of payments.

<sup>1</sup> Author: Vladimír Žďárský (Vladimir.Zdarsky@cnb.cz). The opinions expressed in this article are those of the author and do not necessarily reflect the official position of the Czech National Bank.

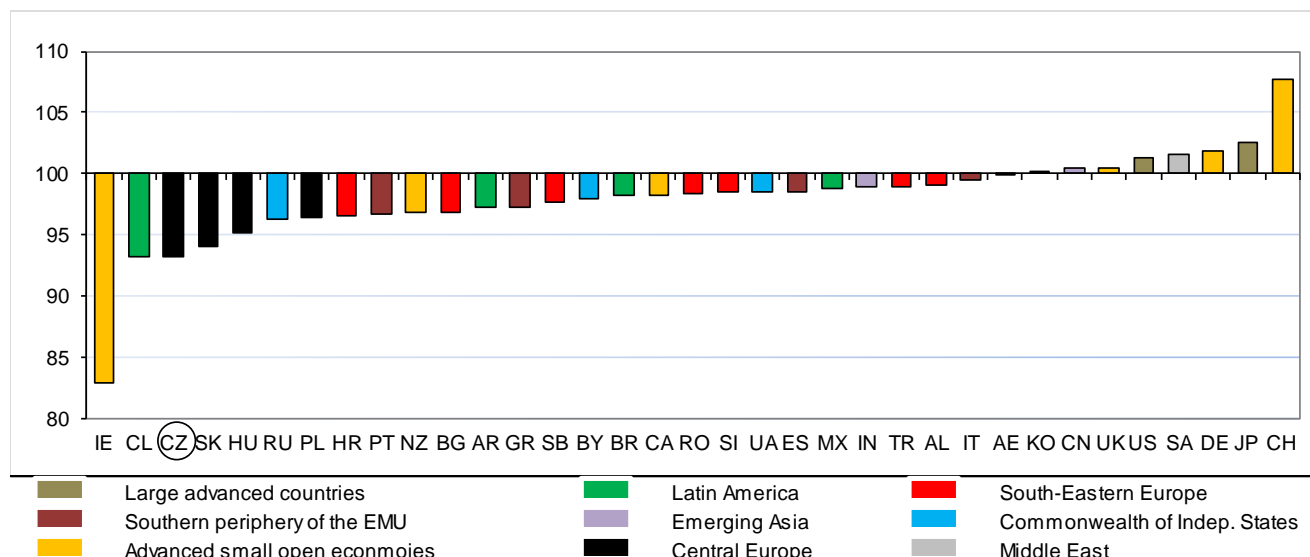
<sup>2</sup> Especially in 1998–2008.

<sup>3</sup> GDP therefore represents the net income generated in the territory of the country regardless of the nationality of the entities which generated it. By contrast, GNP is the net income of residents of the country regardless of the territory in which it was generated.

<sup>4</sup> Internationally widely accepted reserve currencies (the dollar in particular) create specific conditions enabling very long-term imbalances of limited magnitude to be sustained.

This phenomenon is explored in more detail by looking at developments in individual countries using IMF data on nominal GDP and the current account of the balance of payments from 1995 to the present.

**Figure VI-1: GNP/GDP ratios of selected economies (2010, %)**



Note to Figures VI-1–VI-6: IE – Ireland, CL – Chile, CZ – Czech Republic, SK – Slovakia, HU – Hungary, RU – Russia, PL – Poland, HR – Croatia, PT – Portugal, NZ – New Zealand, BG – Bulgaria, AR – Argentina, GR – Greece, SB – Serbia, BY – Belarus, BR – Brazil, CA – Canada, RO – Romania, SI – Slovenia, UA – Ukraine, ES – Spain, MX – Mexico, IN – India, TR – Turkey, AL – Albania, IT – Italy, AE – United Arab Emirates, KO – Korea, CN – China, UK – United Kingdom, US – United States, SA – Saudi Arabia, DE – Germany, JP – Japan, CH – Switzerland, CY – Cyprus.

Source: World Bank

## 2. Difference between GDP and GNP in major economies

The major economies are examined in the first step. Logically, these are large closed economies in which “external goods and financial flows” should play a relatively limited role and the differences between GDP and GNP should be relatively very small, as confirmed by Figure VI-2.

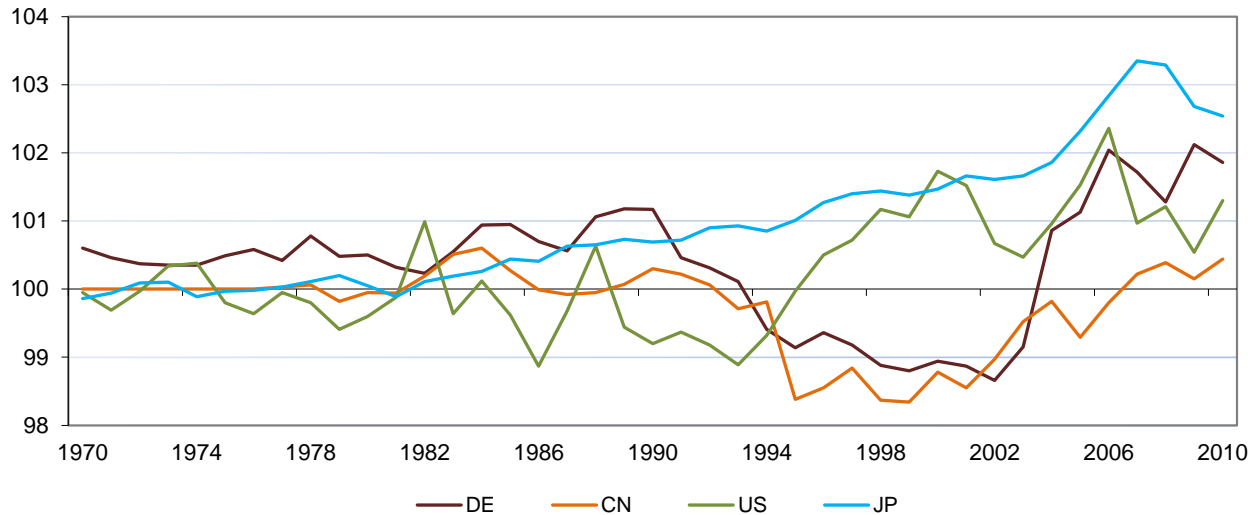
In the 20th century the **USA** was the biggest economic and industrial power and a large exporter of capital, especially after WWII. Its goods and services balance started to deteriorate and its current account deficit started to increase after production of simple goods was gradually moved to East Asia and Latin America. Its current account deficit was 1.5% of GDP in 1995, around 4% in the late 1990s and early 2000s, and a record 6% in the last pre-crisis year of 2006. Later it dropped to 3% of GDP as a result of reduced growth in domestic demand and expanding extraction of shale gas and oil. Nevertheless, its income balance was in surplus throughout the period under review, slightly exceeding 1% of GDP in recent years (thanks to the previous very long period of capital exports, to large corporate assets abroad and to the phenomenon of most important world reserve currency reducing interest costs).

Nominal GDP in **China** increased ten times in the period under review.<sup>5</sup> Initially, the country’s current account was almost balanced (a surplus of 0.2% of GDP) and its goods and services surplus was approximately equal to its income deficit (around 1.6% of GDP). In 2000, the current account surplus was 1.6% of GDP, but the goods and services surplus was almost double the income deficit (a large part of the surplus was invested foreign assets – primarily the country’s foreign reserve assets). In 2005, the

<sup>5</sup> From 1995 to the present

current account surplus was 5.9% of GDP while the income deficit was close to zero. The income balance showed a slight surplus in 2007 and 2008, but returned to a very slight deficit in 2009 (less than 1% of GDP) due to a decline in income (probably a decrease in interest income on foreign reserve assets).

**Figure VI-2: GDP/GNP ratios of major economies (%)**



Source: World Bank

**Germany** recorded a very slight current account deficit until 2000, due mainly to current transfers. The goods and services surplus was constant but not large. In 2002 it started to increase significantly and push the current account into a more sizeable surplus, which exceeded 5% of GDP in 2005. As a result, the income balance switched gradually from a slight deficit to a slight surplus in 2004. The surplus has reached as high as 2% of GDP in recent years.

With just two exceptions, the current account surplus in **Japan** fluctuated between 2% and 4% in the period under review. This was due to trade surpluses and, especially recently, income surpluses. The current account maintained a 2% surplus in 2011, when the goods and services balance showed a slight deficit of around 0.7% of GDP. The income balance has been long recording increasing surpluses, which amounted to around 3% of GDP at the end of the period under review.

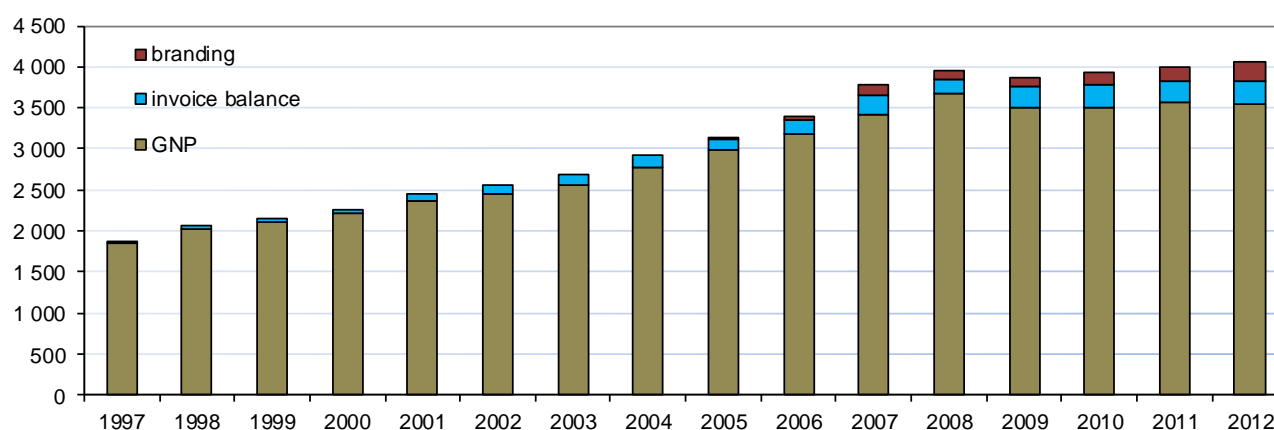
The above account, in combination with Figure VI-2, shows that the differences between GDP and GNP are negligible in major economies (with the possible exception of Japan). The situation is similar in most Western European economies. This explains why this topic is hardly discussed at all in economic journals.

### 3. Difference between GDP and GNP in small open Central European economies

The situation in small open economies, which have used foreign capital to spur fast economic growth, may be different. Quite a sizeable difference between GDP and GNP has gradually arisen in the **Czech Republic** over the last 15 years. However, this country's situation is rather specific. In the switch from a planned to a market economy, it initially opted for loan-based privatisation of (previously state-owned) property into the hands of residents. However, this solution led to enormous problems in the banking sector and problems with the competitiveness of many companies due to bad management and insufficient funds for modernisation. In turn, the current account deficit widened very fast because of a deterioration in the goods and services balance (from a slight surplus in 1993 to more than 6% of GDP in 1996) and foreign exchange

turbulence erupted in May 1997. Later, the privatisation strategy was fundamentally revised in favour of foreign owners (including for the banking sector and network industries) and a system of investment incentives was developed, leading to massive inflows of capital from abroad. Moreover, many domestic entities became non-residents, mainly for reasons of tax optimisation. As a result, the negative difference between GDP and GNP increased from 0.2% of GDP in 1995 to 7.0% of GDP in 2007, not due to long-term imbalances, but due to an unprecedented share of non-residents in the economy (42% of equity, including a high share in monopoly/quasi-monopoly sectors). In recent years this difference has increased no further, but rather has fallen slightly due to the world financial and economic crisis. However, it has stayed above 6% of GDP (except in 2008). Moreover, in recent years, some non-residents have increasingly been using a more tax-efficient method of transferring capital abroad through “branding”,<sup>6</sup> splitting off part of the value of exports and keeping it abroad. In 2006, before the outbreak of the economic and financial crisis, branding amounted to 1.1% of GDP, whereas since 2007 it has increased almost six-fold, reaching 6.2% of GDP in 2012 (see Figure VI-3).<sup>7</sup> Capital outflows abroad also take other forms (such as the depositing of part of the profit of subsidiaries on accounts abroad, and lending to foreign parent companies).

**Figure VI-3: Value added in the Czech Republic and its distribution between residents and non-residents (CZK billions)**



Note: In addition to what share non-residents have in GDP, a great deal depends on what proportion of the funds they reinvest in the territory. The share of reinvestment has dropped sharply in the Czech Republic over recent years to around 15% of non-residents' total profits from direct investment recorded for 2011.

Source: CNB

Intuitively, developments similar to those in the Czech Republic should have been recorded by the other Central European countries except Poland,<sup>8</sup> as they too were large recipients of capital inflows in the late 1990s and early 2000s and their economic history shows similar features.

Statistical data for **Slovakia** indicate a gradual increase in the negative difference between GDP and GNP from very close to zero to 3.2% of GDP in 2008 and a subsequent decrease to 2.4% of GDP in 2011, probably due mainly to a decline in non-

<sup>6</sup> In very simplified terms, branding involves keeping a large part of the price received for exports of goods as a fee for using a well-known brand, providing know-how and ensuring sales.

<sup>7</sup> The GDP generated in the Czech Republic was reduced by the same amount.

<sup>8</sup> In Poland, the state held on to a large part of its property, including banks and network industries, and the nature of Poland makes it a much less open economy than the other three countries.

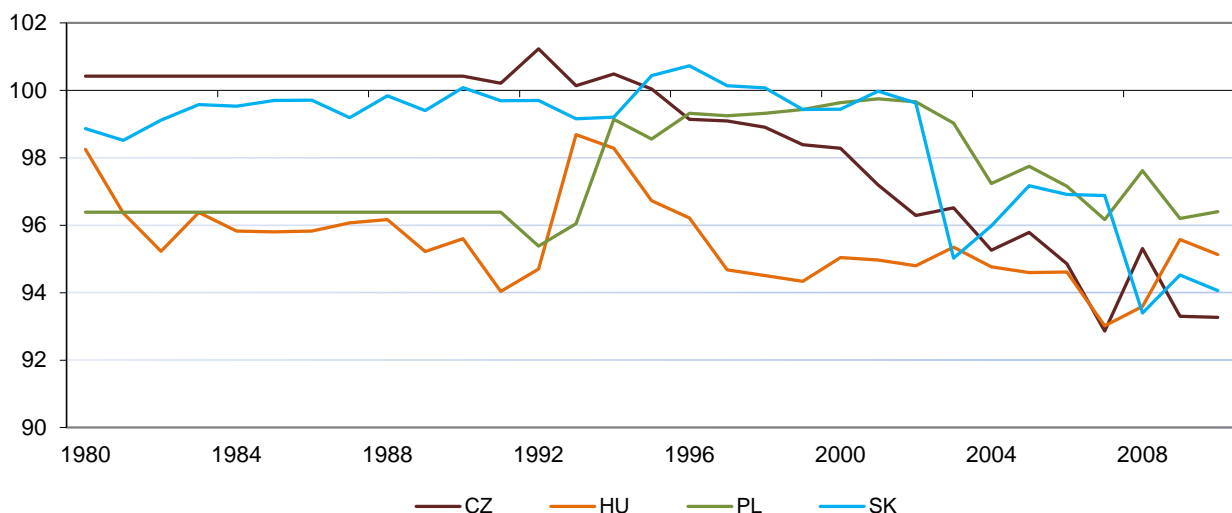


residents' profits associated with the onset of the economic and financial crisis. According to preliminary Slovak estimates, the value of branding is also less than half that in the Czech Republic. Slovakia meanwhile recorded an income deficit of about half the size of that in the Czech Republic amid much larger current account deficits (which have exceeded the safe threshold of 5% of GDP seven times since 1995).

**Hungary** had a relatively large income deficit already in 1995 (3.7% of GDP) as a result of sizeable trade deficits recorded in the past. In the late 1990s and early 2000s the deficit reached 5.5% of GDP, but thanks to fast nominal GDP growth it did not increase in relative terms in the following years. Owing to rising growth in expenditure within the income balance, the deficit started to deepen again in 2006, reaching 6% that year and 7.7% a year later. During the crisis, the deficit decreased slightly to around 5.5%, but in 2011 it rebounded above 6%. Interestingly, the current account recorded a significant change during the crisis, from a deficit of more than 7% in 2008 to a slight surplus in 2010. By 2012, the surplus was in excess of 1.5% of GDP. Branding in Hungary is "reported" to a similar extent as in the Czech Republic.

The **Polish** story is quite different. Poland has a lower share of foreign investors in the economy and has retained significant state stakes in network and regulated industries. It has seen an upward trend in its current account deficit from zero in 1995 and recorded a sharp rise in imbalances in 2007 and 2008 (a deficit of 6.6% of GDP) amid much faster nominal GDP growth than in the Czech Republic and Hungary. However, its income deficit was well below 1% at the end of the 1990s. More pronounced growth can be observed in 2004 (3.3% of GDP); in 2007 it stood at 3.8%. Faster growth in the income deficit in relative terms was prevented by sharp growth in nominal GDP. Unlike in the other Central European countries, the income deficit rose further during the crisis (to 4.0% in 2010 and 4.4% in 2011). An even sharper increase was prevented by still fast growth in nominal GDP.

**Figure VI-4: GDP/GNP ratios of small open Central European economies (%)**



Source: World Bank

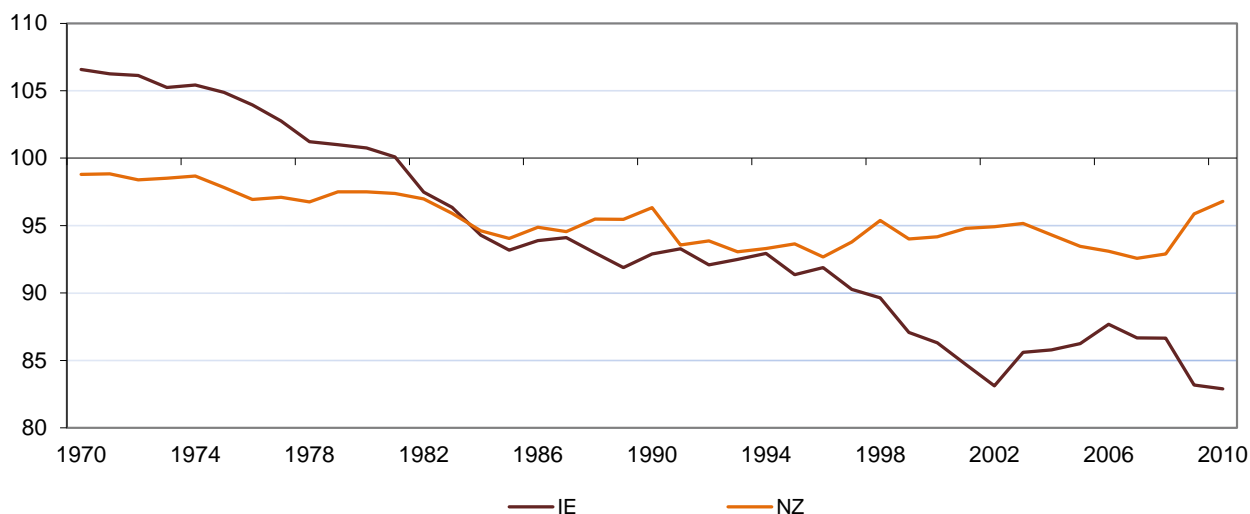
Two reasons can be put forward for the relatively large differences between GDP and GNP in the Czech Republic and the other Central European countries (see Figure VI-4). Poland and Slovakia are large exporters of labour, and this positively affects their income balance. But this by no means explains the entire difference between the countries. The other reason is the above-mentioned privatisation of companies operating in industries with limited competition in the Czech Republic (energy, water

supply, telecommunications, the banking sector, etc.) into the hands of non-residents, which was not done in Poland in particular. Far higher profits can be made in these sectors, and this is the main reason for the large income deficit in the Czech Republic. The lower levels in Poland are also due to the different nature of its economy (relatively large and closed). The ratios in the other Central European countries are reduced by faster growth in nominal GDP, thanks partly to much higher inflation than in the Czech Republic in the period under review. The situation in Hungary is the most similar to that in the Czech Republic. Although Hungary has a much higher debt than the Czech Republic, its current account has been showing a slight surplus for several years and it thus has some leeway to cut its external debt ratio or improve its investment position. Should the current trend continue, the Czech Republic might record a slight current account surplus next year (for the first time since 1993). Foreign corporations appear to be successfully maintaining high profits in Central Europe at the cost of restrained growth in wages and employment. The limited options of public budgets make it impossible to counteract these tendencies. The trends in Poland and Hungary are essentially in line with expectations. The Slovak data – indicating a difference between GDP and GNP that is less than half that in the Czech Republic – are inexplicable to us.

#### 4. Difference between GDP and GNP in small open advanced economies

This section will examine in detail advanced countries with similar characteristics of significantly lower GNP than GDP (see Figure VI-5) and the possible implications for future developments in Central European countries. Among large countries, New Zealand and Ireland have high income deficits.

**Figure VI-5: GNP/GDP ratios of Ireland and New Zealand (%)**



Source: World Bank

The deficit in **New Zealand** already exceeded 6% of GDP in the second half of the 1990s. Following a temporary decline due to fast GDP growth after 2000, it peaked at 7.7% of GDP in 2008. After a sharp drop of almost 50% at the start of the crisis (probably a decline in non-residents' profits), it started to increase gradually again to 5.4% in 2011. Unlike the Czech Republic and Hungary, the large income deficits were accompanied by large current account deficits, which were usually even higher. During the crisis, however, they dropped significantly below the income deficit (2.7% in 2009), before starting to rise again (4.2% in 2011).

The **Irish** economy is the most unusual case. The country showed sizeable current account surpluses at the end of the 1990s despite growth in the income balance, which

already exceeded 10% of GDP in the mid-1990s (reaching a record high of 15.2% of GDP in 1998). Later it edged down in relative terms due to faster growth in GDP than in the income deficit. In 2000, however, the income deficit started to drag the current account into deficit, and in 2001 it began to rise in relative terms as well (-18% of GDP in 2002), with growth in the deficit again outpacing GDP growth. The current account deficit also rose significantly in 2005 (to 3.5% of GDP), exceeded 5% of GDP in 2007 (referred to as a “relatively safe level” in the literature) and peaked at 5.8% in the crisis year of 2008 (when the income deficit stood at 14.1% of GDP). Subsequently, the current account deficit started to shrink quickly in both absolute and relative terms, although nominal GDP also fell relatively rapidly. In 2010, the current account switched back to a very slight surplus of around 1.1% with an upward trend. Despite a decline in non-residents’ profits, the income balance did not fall in absolute terms thanks to a decrease in assets. With nominal GDP falling rapidly, this led to a further rise in the income deficit in relative terms (to 17.4% in 2009 and a record 20.4% of GDP in 2011). It should be borne in mind, however, that, unlike the other countries, Ireland uses extremely supportive tax policy to prevent rapid outflows of capital. (However, the income balance does not allow us to distinguish what proportion is reinvested earnings and what proportion goes abroad.)

The developments in Ireland suggest certain risks for an economy that is heavily dependent on foreign capital. A situation may arise where such a country reaches a certain level of GDP growth but its GNP declines at the same time and its population grows poorer.

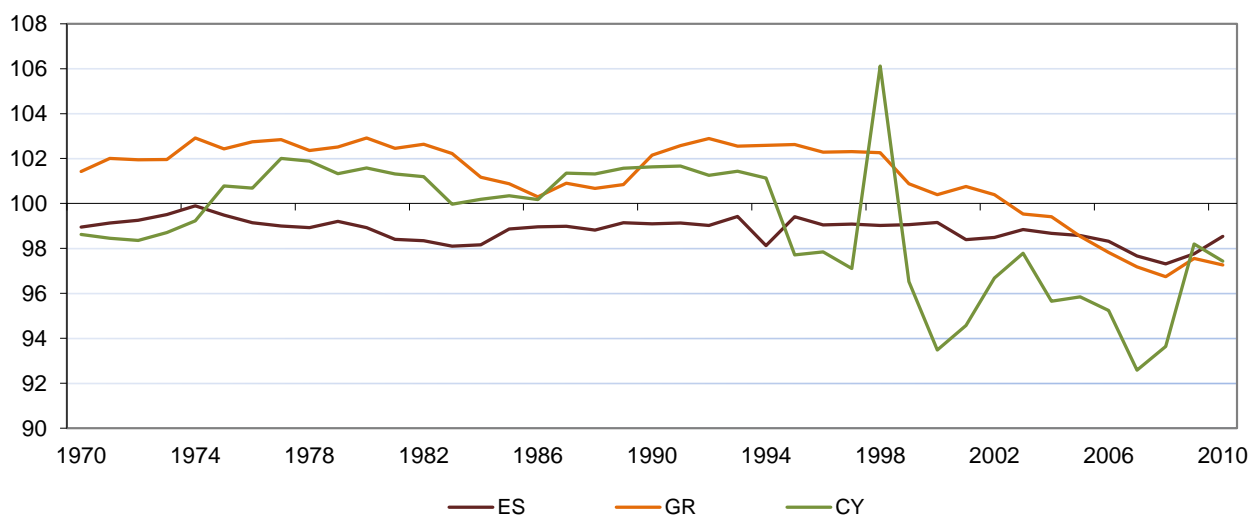
### 5. Difference between GDP and GNP in advanced economies with external imbalances

In this final section we focus on countries that were de facto unable to meet their obligations due to problems in the banking sector or bad management of public finances (see Figure VI-6).

**Spain** is a typical example of a country with a large external imbalance that started to accumulate following the introduction of the euro (the current account was virtually balanced in 1997, but by 2008 its deficit had reached 9.7% of GDP); moreover, in relative terms, the visibility of the external imbalance was reduced by fast GDP growth. The income deficit peaked at 3.2% of GDP in 2008 and then dropped significantly, just like the external imbalance. Spain’s current problems (risky assets of the banking sector and a potential failure to cope with government debt) are of a different nature and are not reflected in the indicators under review.

The data for **Greece** show faster growth in the income deficit after 2000 (previously around 1% of GDP), evidently associated with the costs of financing the growing current account deficit. The latter started to creep up in the late 1990s and escalated extremely sharply in 2006–2008 (to 11.3%, 14.6% and 15% of GDP respectively). As a result, the income deficit increased gradually to 3.4%, 4.1% and 4.7%. The two deficits decreased in absolute terms after the onset of the crisis, but nominal GDP declined simultaneously. The deficits thus decreased only slightly in relative terms (the current account to 9.9% and the income deficit to 4.1% of GDP in 2011).

The income deficit in **Cyprus** was around 2.5% of GDP in the mid-1990s then rose gradually to 5.8% of GDP in 2000. In the following years it fell to just above 3% of GDP. A surplus was even recorded in 2011. The current account deficit remained relatively low in this period and declined in relative terms. It peaked in 1997 (at 4.7% of GDP) and was just 2.2% of GDP in 2003. However, it then started to surge until 2008, when it reached an extraordinary 15.3% of GDP. Subsequently, it dropped to less than a third (4.7% of GDP in 2011), mainly because of a decline in the goods and services balance

**Figure VI-6: GDP/GNP ratios of advanced countries with external imbalances**

Source: World Bank

The data show no major connection between the problems of these countries and the income balance. All that is visible is a sharp increase in GDP in a short time period before the crisis in 2008, amid an extremely sharp rise in external imbalances on the current account, associated with growth in demand for imports.

We should add for completeness that among the emerging economies there are many small – often island – countries where the deviations between GDP and GNP (in both directions) are much higher than in the countries mentioned above (up to one-third of their GDP). The countries with the largest deviations have included in recent years: (i) those where GNP is more than 20% lower than GDP (Equatorial Guinea, Congo, Puerto Rico, Chad, Iceland and Luxembourg) and conversely (ii) those where GNP is higher than GDP (Bermuda, Kiribati, Marshall Islands, Lesotho and Timor).

## 6. Conclusion

Overall, we can confidently assert that economic articles on this topic will certainly not become a global hit, as for the majority of advanced and major global economies the difference between GDP and GNP is either negligible or, as, for example, in the case of Japan and Switzerland, on the more “pleasant” side of the deviation, with previous exports of capital allowing them to achieve (enjoy) higher national product than gross domestic product (i.e. product generated on their territory). Moreover, the deviation between GDP and GNP has only a limited function as an indicator of future problems, because it does not distinguish the quality of external assets. Monitoring this indicator would not have helped the authorities to detect in time the problems which recently emerged, for example, in Iceland, Cyprus and Ireland. Nor did the deviation signal the recent sharp deterioration in economies with extreme current account imbalances (Spain, Greece, Cyprus, etc.). This was probably because of the relatively limited period of excessive deficits and strong GDP growth at that time. On the other hand, the deviation allows us to distinguish between internal and external debt. Therefore, it does not indicate any problems in Japan, since its massive government debt is mostly reported in respect of the domestic population and, in addition, domestic entities have substantial external asset holdings.

Turning to larger and more advanced economies, the Czech Republic, Hungary, Ireland and New Zealand have long recorded significantly lower GNP than GDP. The large

deficits of these countries were associated more with a high proportion of foreign direct investment in the economy in the past than with large imbalances. Strong outflows of capital are currently causing these countries problems. Reducing these outflows is therefore discussed quite frequently in the literature. In Ireland, keeping foreign capital in the country seems to have been sufficiently safeguarded by a policy of extremely low corporation tax rates. In the other countries the situation is more complex. As regards investment in competitive and export-oriented industries, an increase in taxation might lead to a shift of capacities to countries with more favourable conditions, to growth in unemployment and to a decline in the external competitiveness of the country. Some leeway exists only in network industries and in industries benefiting from imperfect competition and operating predominantly on the domestic market. Possible ways of reducing capital outflows include, for example, introducing price regulation or higher taxes on corporations in specific industries, increasing contributions to deposit insurance schemes or changing the rules for provisioning for risky assets in the banking sector. This is the path that has been taken by Hungary, for example. In Slovakia, a debate is now starting about reducing capital outflows abroad, even though the outflow of capital there is smaller according to the available statistical data.

### A1. Change in GDP predictions for 2013

	CF		IMF		OECD		CB / EIU	
<b>EA</b>	0.0	2013/8 2013/7	-0.3	2013/7 2013/4	-0.5	2013/5 2012/11	-0.1	2013/6 2013/3
<b>US</b>	-0.3	2013/8 2013/7	-0.2	2013/7 2013/4	-0.1	2013/5 2012/11	-0.1	2013/6 2013/3
<b>DE</b>	0.0	2013/8 2013/7	-0.3	2013/7 2013/4	-0.2	2013/5 2012/11	-0.1	2013/6 2012/12
<b>JP</b>	0.0	2013/8 2013/7	0.4	2013/7 2013/4	0.9	2013/5 2012/11	0.0	2013/7 2013/4
<b>BR</b>	-0.2	2013/8 2013/7	-0.5	2013/7 2013/4	-1.1	2013/5 2012/11	-0.5	2013/8 2013/7
<b>RU</b>	0.0	2013/8 2013/7	-0.9	2013/7 2013/4	-1.5	2013/5 2012/11	0.0	2013/8 2013/7
<b>IN</b>	-0.4	2013/8 2013/7	-0.1	2013/7 2013/4	-1.2	2013/5 2012/11	0.0	2013/8 2013/7
<b>CN</b>	0.0	2013/8 2013/7	-0.2	2013/7 2013/4	-0.7	2013/5 2012/11	0.0	2013/8 2013/7

### A2. Change in inflation predictions for 2013

	CF		IMF		OECD		CB/EIU	
<b>EA</b>	0.0	2013/8 2013/7	0.1	2013/4 2012/10	-0.1	2013/5 2012/11	-0.2	2013/6 2013/3
<b>US</b>	0.0	2013/8 2013/7	0.0	2013/4 2012/10	-0.2	2013/5 2012/11	-0.5	2013/6 2013/3
<b>DE</b>	0.0	2013/8 2013/7	-0.3	2013/4 2012/10	-0.3	2013/5 2012/11	0.1	2013/6 2012/12
<b>JP</b>	0.1	2013/8 2013/7	0.3	2013/4 2012/10	0.4	2013/5 2012/11	0.0	2013/7 2013/4
<b>BR</b>	0.0	2013/8 2013/7	1.2	2013/4 2012/10	0.9	2013/5 2012/11	0.0	2013/8 2013/7
<b>RU</b>	0.1	2013/8 2013/7	0.3	2013/4 2012/10	0.2	2013/5 2012/11	-0.1	2013/8 2013/7
<b>IN</b>	0.4	2013/8 2013/7	1.2	2013/4 2012/10	0.7	2013/5 2012/11	0.0	2013/8 2013/7
<b>CN</b>	0.0	2013/8 2013/7	0.0	2013/4 2012/10	1.0	2013/5 2012/11	0.0	2013/8 2013/7

### A3. List of abbreviations

<b>BoJ</b>	Bank of Japan	<b>DBB</b>	Deutsche Bundesbank
<b>BR</b>	Brazil	<b>DE</b>	Germany
<b>BRIC</b>	Brazil, Russia, India and China	<b>EA</b>	euro area
<b>CB-CCI</b>	Conference Board Consumer Confidence Index	<b>EC</b>	European Commission
<b>CB-LEII</b>	Conference Board Leading Economic Indicator Index	<b>ECB</b>	European Central Bank
<b>CBOT</b>	Chicago Board of Trade	<b>EC-CCI</b>	European Commission Consumer Confidence Indicator
<b>CF</b>	Consensus Forecasts	<b>EC-ICI</b>	European Commission Industrial Confidence Indicator
<b>CN</b>	China	<b>EIU</b>	The Economist Intelligence Unit database
<b>CNB</b>	Czech National Bank	<b>EEA</b>	European Economic Area

<b>ES</b>	Spain	<b>IT</b>	Italy
<b>EU</b>	European Union	<b>JP</b>	Japan
<b>EMI</b>	European Monetary Institute	<b>JPY</b>	Japanese yen
<b>EURIBOR</b>	Euro Interbank Offered Rate	<b>LIBOR</b>	London Interbank Offered Rate
<b>Fed</b>	Federal Reserve System (the US central bank)	<b>N/A</b>	not available
<b>FRA</b>	forward rate agreement	<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>GBP</b>	pound sterling	<b>OECD-CLI</b>	OECD Composite Leading Indicator
<b>GDP</b>	gross domestic product	<b>PMI</b>	Purchasing Managers' Index
<b>GR</b>	Greece	<b>PT</b>	Portugal
<b>CHF</b>	Swiss franc	<b>RU</b>	Russia
<b>ICE</b>	Intercontinental Exchange	<b>UoM</b>	University of Michigan
<b>IE</b>	Ireland	<b>UoM-CSI</b>	University of Michigan Consumer Sentiment Index
<b>IFO</b>	Institute for Economic Research	<b>US</b>	United States
<b>IFO-BE</b>	IFO Business Expectations	<b>USD</b>	US dollar
<b>IMF</b>	International Monetary Fund	<b>ZEW-ES</b>	ZEW Economic Sentiment
<b>IN</b>	India		
<b>IRS</b>	interest rate swap		

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